Service Date: October 22, 1998

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF the Application of U S WEST Communications, Inc. to Offer Single Line ISDN Service and Integrated Services Digital Network Primary Rate Service.	)	UTILITY DIVISION DOCKET NO. D96.7.121 ORDER NO. 5940e

FINAL ORDER

I. Introduction and Procedural Background

1. On June 28, 1996, U S WEST Communications, Inc. (U S WEST) filed an application with the Montana Public Service Commission (Commission) to provide Integrated Digital Network Services (ISDN) at tariffed rates. The filing was designated Docket No. D96.7.121.

2. U S WEST's application explained that the purpose of this filing is to offer Single Line ISDN on a 2B + D Basic Rate Service (BRS) line arrangement and Primary Rate Service ISDN (PRS) with either a 23 B-Channel and one D-Channel (23 B + D) or with 24 B-Channels (24 B). BRS provides up to three distinct channels, with integrated voice and data features on a 2B + D line, on one pair of wires. PRS provides a digital four-wire full duplex transmission path at 1.544 MBPS equivalent to a T1 channel. Each channel in this service operates at 64 kbps carrying user information such as voice, data or video.

3. For BRS, the tariff provides for a $110 non-recurring charge[1] and a recurring monthly charge based on three rate options: (1) fully measured at $39.00 per month plus $.01 per minute; (2) measured at $68.00 per month, plus $.01 per minute for usage over 200 hours; and

(3) flat rated at $184 per month, with unlimited usage. PRS is offered at $400 per month with a non-recurring charge of $1,025.

4. U S WEST's filing also included a Rate Stability Plan (RSP) for both ISDN offerings. The RSP for PRS service is offered for three, five, seven, or 10 years; for BRS service, the RSP is offered for two, three, or five years for customers opting for the 200-hour usage or the flat rate option with 50 lines or more.

5. The Commission received letters from AT&T Communications of the Mountain States, Inc. (AT&T) and MCI Telecommunications Corporation (MCI) opposing the proposed prices, terms and conditions and requesting that the filing be suspended and set for a hearing. On August 5, 1996, the Commission voted to suspend the filing and set the matter for hearing.

6. The Commission issued a notice of the application permitting interested parties to intervene and/or comment on the filing. The Montana Consumer Counsel (MCC), AT&T and MCI petitioned for and were granted intervention.

7. On August 20, 1996, the Commission approved U S WEST's ISDN filing on an interim basis, pending the outcome of the hearing in this Docket. The Commission issued the Procedural Order on September 3, 1996, establishing March 19, 1997 as the date for the hearing to commence.

8. Pursuant to U S WEST's January 1997 request, the Commission vacated the March 19, 1997 hearing date and granted a two-month extension of time for U S WEST to file rebuttal testimony. U S WEST requested and was granted a further extension of time to file rebuttal testimony by May 15, 1997. The Commission rescheduled the hearing for October 16 and 17, 1997 following a procedural conference held in May 1997.

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[1] In addition, customers more than 18 kilofeet from the serving central office will be charged an additional one-time fee of $100, to recover costs associated with conditioning the longer loop.

9. This Docket has been fraught with discovery disputes and procedural errors by the parties. The Commission issued Order No. 5940b dated June 25, 1997, in which it sanctioned AT&T, prohibiting it from opposing U S WEST's Motion to Compel and prohibiting it from supporting the relevance claims it made in answers to data responses. AT&T, an active participant in this proceeding, withdrew from this proceeding on July 9, 1997 after the Commission granted U S WEST's Motion to Compel in Order No. 5904b.

10. That left MCI as the only active intervenor. However, MCI had supported the testimony provided by AT&T's witnesses and had not planned to offer a costing witness of its own until AT&T withdrew from the proceeding. MCI hired a costing witness, but this witness was unable to be present on the hearing dates scheduled in October 1997. On September 12, 1997, MCI filed a motion to vacate and reschedule the hearing. Also on September 12, 1997, U S WEST filed a motion to vacate the hearing date and other procedural deadlines due to an unresolved discovery dispute with MCI.

11. MCI failed to follow the procedural process that had been specified in prior Commission orders in this Docket and U S WEST again moved to compel answers to data requests. MCI threatened to withdraw from the case if the Commission ordered it to respond to data requests to which it had objected. Both parties hurled accusations about the other's discovery motives. The Commission noted its concern with how the case had degenerated, but stated it will not be held hostage to threats. Despite MCI's failure to heed the warning in Order No. 5940b, there was good reason to set aside the pattern of discovery abuse that had evolved and to address the discovery disputes on their merits. Order No. 5940c granted U S WEST's motion in part, denied it in part, struck certain data requests and required U S WEST to clarify some data requests. The Commission subsequently sustained MCI's objections to the clarified data requests on January 15, 1998.

12. After several informal requests from Commission staff to reset the hearing or otherwise reinstate a procedural schedule, U S WEST filed a Motion in Limine on May 26, 1998. The Motion in Limine stated that the parties wished to avoid a hearing in this proceeding, that they believe their respective positions can be adequately and fairly adjudicated based on a stipulated record, and that they each waived the cross-examination of the other party's witnesses. U S WEST also waived its right to present testimony in rebuttal to MCI's witness. U S WEST requested the Commission issue an order determining that the issues in this proceeding will be decided on a stipulated record consisting of the prefiled direct and rebuttal testimony of Mr. Merlin Jenson (U S WEST), Ms. Geraldine Santos-Rach (U S WEST), and Ms. Rebecca Bennett (MCI), and the data responses provided by these three witnesses; and establishing a briefing schedule.

13. The Commission granted U S WEST's motion in Order No. 5940d dated June 2, 1998 and established a briefing schedule to be completed by July 20, 1998.

14. U S WEST and MCI filed briefs in this docket addressing two contested issues- whether U S WEST's proposed rates for BRS ISDN are too high, and whether the Commission should approve U S WEST's rate stability plan (RSP). The Commission makes the following findings, conclusions and order.

II. Findings of Fact and Commission Decision

A. Rates for BRS ISDN

15. U S WEST presented testimony from Mr. Merlin Jenson and Ms. Geraldine Santos-Rach to support the proposed BRS prices. MCI presented testimony from Ms. Rebecca Bennett.

16. Although Mr. Jenson's testimony indicates that rates were not set according to their associated costs, he testified that the proposed rates are above costs as estimated in U S

WEST's Average Direct and Shared Residual (ADSRC) cost study. U S WEST contends that the proposed rates for BRS service are not priced unreasonably high. Although U S WEST admits that its proposed rates do not cover costs as estimated by the TSLRIC+ SC, it urged the Commission to allow the interim rates to become final, and to address costing issues later.

17. In rebuttal testimony, Ms. Geraldine Santos-Rach sponsored U S WEST's Total Service Long Run Incremental Cost plus Shared Costs (TSLRIC + SC) study. Ms. Santos-Rach admitted that there are flaws in U S WEST's ADSRC cost model, and stated that U S WEST developed the TSLRIC +SC study to correct these deficiencies.

18. Ms. Santos-Rach argued that the proposed ISDN rates are reasonable. The ADSRC cost study originally submitted by U S WEST estimates lower costs for ISDN than does the TSLRIC + SC study that Ms. Santos-Rach filed with her rebuttal testimony.[2] The TSLRIC + SC study was completed after the initial filing of this docket, and she asserts that had the TSLRIC + SC study been completed at the time of the filing, U S WEST would have proposed some higher rates.

19. MCI contends that U S WEST's proposed rates are not just and reasonable and they are not based on true costs as estimated by a proper cost study. Ms. Rebecca Bennett on behalf of MCI criticized U S WEST's proposed rates for BRS ISDN service. Ms. Bennett claimed that setting rates that are based on arbitrary comparisons to regular service allows U S WEST to "price gouge" customers because U S WEST is currently a monopoly provider of ISDN services. MCI argues that it is important to base rates on true costs in order to avoid price gouging. Ms. Bennett testified that U S WEST's proposed rates were well above costs, and were not based on an appropriate cost study.

[2] U S WEST claims that these differences are due to major changes U S WEST made to its costing methodology after its initial ISDN filing. Santos-Rach testifies that these changes were made, in part, in response to criticisms they received in a New Mexico ISDN docket.

20. Ms. Bennett testified that rates for ISDN service should be based upon a proper TSLRIC (total service long run incremental cost) study with imputation and that the Commission should require U S WEST to file a proper TSLRIC study. MCI further recommended that the Commission require U S WEST to "impute into all service rates the same charges that would be imposed on its competitors for resale purposes." This, Ms. Bennett asserted, would ensure that customers receive a fair price and enable competitors to enter the ISDN market on either a facilities or a resale basis.

21. Ms. Bennett supported her claim that U S WEST's ADSRC cost studies are flawed with evidence from similar proceedings in New Mexico and Utah. The New Mexico State Corporation Commission rejected cost studies similar to those filed in this Docket and adopted a revised ISDN rate schedule proposed by U S WEST. In New Mexico, U S WEST agreed to the following ISDN rate schedule: $39 for measured service, $50 for measured service with 40 hours free, and $75 for flat rate service. Ms. Bennett argued that New Mexico is a rural state similar to Montana, and that U S WEST's costs would be similar in both states. In lieu of a proper cost study, Ms. Bennett recommended adopting a pricing schedule similar to that adopted by the New Mexico Commission.

22. Although Ms. Bennett suggested that the Commission adopt a rate structure similar to the one approved in New Mexico, there is no evidence in the record to support any costing methodology other than the two cost studies filed by U S WEST, and MCI has not addressed how the cost studies may be improved.

23. Evidence in this and other dockets raises serious questions about the accuracy of U S WEST's TSLRIC +SC model. The Commission concludes that ISDN should not be priced in isolation and that issues related to the costing model should be addressed in a more comprehensive costing docket. For this reason, it also is not appropriate to address MCI's

argument that the Commission set ISDN rates with imputation. This issue also can be resolved in a subsequent comprehensive retail service costing docket.

24. Mr. Jenson also testified that the BRS monthly rate options were derived from the substitutability and the increased capabilities of ISDN compared to the price and functionality of a regular business line. He testified that the fully measured rate option was designed for the very small user, including residential customers. The measured rate with 200-hour usage was designed for small business. In other words, the fully measured option would roughly substitute for the 1FR and the measured rate with 200-hour usage would roughly substitute for the 1FB.

25. As an example, Mr. Jenson testified that the $68 price for the measured service with a 200-hour free usage allowance approximates the price of a single business line with six optional features that are included with basic ISDN service.[3] He testified that businesses that opt for ISDN receive a significant bargain over the price of two business lines because ISDN effectively gives customers two lines using a single copper wire pair.

26. Mr. Jenson argued that setting prices below the proposed rates would "inappropriately stimulate demand" and cause potential customer complaint problems. He stated that ISDN is not a basic or essential service. Mr. Jenson explained that ISDN has many advantages over a regular voice grade business line including dual and simultaneous processing of voice and data, remote LAN access for employees who work at home, and faster internet access.

27. Ms. Bennett disagreed with U S WEST's testimony that ISDN is not an essential service and stated that setting lower rates based on costs cannot stimulate demand

[3] These features include Caller ID, Call Waiting, Three-way Calling, Speed Call 8, Call Forward Busy Line/ Don't Answer, and Call Transfer.

inappropriately. She argued that products should not be priced to discourage customers from subscribing to the service.

28. The Commission concludes that it is not clear that ISDN is a substitute for either the 1FB or the 1FR for the following reasons. First, marketing for ISDN has emphasized its use for high-speed data transmission, not as a substitute for 1FR or 1FB service. Second, it is not evident that the six features listed in the comparison are actually features that would be individually ordered by a residential or business customer. It is more likely that these customers would choose currently tariffed packages that cost less and include more options rather than purchasing those options ala carte as is shown in the price comparison. Moreover, it is doubtful that ISDN would be marketed as a substitute for feature combinations that are unlikely to be sold in the first place.

29. Third, it is unclear how ISDN services can simultaneously substitute for both 1FR and 1FB services. It is likely that some businesses would subscribe to the first, fully measured service option, which Mr. Jenson testified was priced to be a substitute for 1FR service. This calls into question Jenson’s argument that pricing ISDN too low will inappropriately stimulate demand, because the proposed measured rate is far below the rate that would be charged for two business lines. These factors make suspect any argument that ISDN is a substitute for either the 1FR or 1FB.

30. The Commission approves U S WEST’s proposed ISDN rates on a permanent basis for all ISDN services. In so doing, the Commission specifically does not address the merit or accuracy of U S WEST’s TSLRIC + SC cost model. Rather, the Commission reserves final judgement on the basis for these rates until they can be addressed in a comprehensive retail-costing docket.

B. The Rate Stability Plan

31. MCI asserts that its proposed “fresh look” would allow consumers to take advantage of rate stability now and also allow them to take advantage of lower priced competitive offers of ISDN when competition becomes available. MCI notes that both the FCC and the Wisconsin Public Service Commission have used “fresh look” proposals to further competition.

32. Ms. Bennett argued that the U S WEST’s RSP is anti-competitive and anti-consumer because it locks customers into long-term contracts before customers have a competitive choice and imposes termination fees for discontinuing the services before the contract term is completed. She suggested that the Commission require U S WEST to allow RSP customers a “fresh look” upon entry by another provider of ISDN. A “fresh look” would allow customers to reevaluate their options at that time without incurring prohibitive penalties. Ms. Bennett further testified that MCI is not recommending that no termination fee be applied, only that those fees be based on costs not recovered. She claimed that the “fresh look” option would allow customers to evaluate their options when new competitors and/or technologies become available.

33. Ms. Bennett further testified that the long-term contracts are anti-consumer because they lock customers into long-term contracts at high rates. She claimed that this is anti-consumer because newer, faster, and cheaper technologies such as ADSL (Asymmetrical Digital Subscriber Line) service are likely to be deployed in the very near future and that prices for ISDN would probably decrease in the next three to five years.

34. Mr. Jenson rebutted MCI’s claims that U S WEST’s proposed RSP is inappropriate and noted that AT&T and others commonly use customer contracts to offer lower rates with no adverse affects to competition. Mr. Jenson also claims that MCI’s “fresh look”

proposal is a tactic to allow MCI to "snatch U S WEST's customers" and to allow U S WEST's customers to breach their agreements.

35. U S WEST argued that its RSPs are neither anti-competitive nor anti-consumer and asked that the Commission reject MCI's "Fresh Look" proposal. U S WEST pointed out that RSPs are only available to sophisticated customers who would have sufficient information to make their own economic decisions, such as entering into long-term contracts. U S WEST also argues that the application of "fresh look" to a service such as ISDN is "so onerous that U S WEST would withdraw its RSP proposals for ISDN services before marketing them under a 'fresh look' regime."[4]

36. The Commission is concerned about the use of long-term contracts for U S WEST services and their possibly adverse affect on competition, especially when these contracts affect residential customers. However, the Commission concludes that the RSP in these tariffs are most likely to be used by large businesses who should be sophisticated enough to make rational choices when entering into long-term contracts.

37. U S WEST has indicated that the only RSP contract lengths currently in use by U S WEST's Montana customers are the three-year and five-year PRS service contracts.[5] U S WEST suggested that the Commission approve only these RSP contract lengths.

38. Given the specific nature of this filing, the Commission concludes that limiting the RSP to permit three-year and five- year contracts for only the PRS ISDN sufficiently addresses the appropriateness of long-term contracts in this docket. The Commission may revisit long-term contract issues in a future docket.

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[4] U S WEST's Brief, at 10.
[5] U S WEST's legal counsel, John Alke communication with Commission staff, September 9, 1998. U S WEST has not negotiated any BRS contracts.

III. Conclusions of Law

1. The Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA. U S WEST is a public utility offering regulated telecommunications services in the State of Montana. Section 69-3-101, MCA.

2. The Commission has authority to do all things necessary and convenient in the exercise of the powers granted to it by the Montana Legislature and to regulate the mode and manner of all investigations and hearings of public utilities and other parties before it. Section 69-3-103, MCA.

3. Adequate public notice and an opportunity to be heard has been provided to all interested parties in this Docket, as required by the Montana Administrative Procedure Act, Title 2, Chapter 4, MCA.

IV. Order

THEREFORE, based on the foregoing, IT IS ORDERED that U S WEST's ISDN tariff filing is approved as discussed in this Order.

DONE AND DATED this 20th day of October, 1998 by a vote of 4-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

NANCY MCCAFFREE, Vice Chair

BOB ANDERSON, Commissioner

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.